No. 1085.

Supreme Court of the United States

OCTOBER TERM, 1924.

MIDDLETON S. BORLAND, as Trustee in Bankruptcy of Knauth, Nachod & Kuhne,

Petitioner,

against

UNITED STATES OF AMERICA,

Respondent.

BRIEF FOR PETITIONER

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Supreme Court of the United States,

OCTOBER TERM, 1924.

MIDDLETON S. BORLAND, as Trustee in Bankruptcy of Knauth, Nachod & Kuhne, Petitioner, *against* UNITED STATES OF AMERICA, Respondent.	No. 1085.

BRIEF FOR PETITIONER.

This case comes here upon a writ of certiorari issued to the Circuit Court of Appeals for the Second Circuit, which court affirmed an order of the United States District Court for the Southern District of New York. The order of the District Court in turn affirmed an order of the Referee in Bankruptcy, which latter order decreed that the debt due the Postmaster General was entitled to prior payment over the debts due the general creditors of the bankrupts.

Question Presented.

The question presented is whether a contract debt due to the United States of America is entitled to payment before the debts due to ordinary creditors. Specifically the question is whether the debt is a debt owing to a "person" who by the laws of the United States is entitled to priority within the meaning of Section 64 (*b*) (5) of the Bankruptcy Act of 1898. If the United

States itself is a "person" within the meaning of that Section, then it is entitled to priority, because by a law of the United States, to wit, 3466 of the Revised Statutes, the United States would be entitled to priority. Stated in another way, the question is whether or not Section 3466 of the Revised Statutes has been incorporated by reference into the Bankruptcy Act by virtue of Section 64 (*b*) (5).

Applicable Statutes.

Bankruptcy Act.

Section 64 of the Bankruptcy Act, 30 Stat. 563, as amended by 32 Stat., 800, and 34 Stat., 267 (Comp. Statutes, §9641), provides:

> "Debts which have priority.—(*a*) The court shall order the trustee to pay all *taxes* legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors, and upon filing the receipts of the proper public officers for such payment he shall be credited with the amount thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court.
>
> (*b*) The debts to have priority, except as herein provided, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the actual and necessary cost of preserving the estate subsequent to filing the petition; (2) the filing fees paid by creditors in involuntary cases, and, where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the expense of one or more creditors, the reasonable expenses of such recovery; (3) the cost of administration, including the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United

States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases, to the bankrupt in involuntary cases while performing the duties herein prescribed, and to the bankrupt in voluntary cases, as the Court may allow; (4) wages due to workmen, clerks, traveling or city salesmen, or servants which have been earned within three months before the date of commencement of proceedings, not to exceed three hundred dollars to each claimant; and (5) *debts owing to any person who by the laws of the States or the United States is entitled to priority.*"

3466 Revised Statutes.

Section 3466 of the Revised Statutes (Compiled Statutes of 1916, Section 6372), provides as follows:

> "Priority established.—Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

Statement of Facts.

A proof of claim was filed with the Referee by the United States of America in the sum of $148,403.02, based upon certain drafts purchased by the Post Office Department prior to the bankruptcy, which drafts were outstanding and unpaid when the petition was filed. The Trustee filed an objection to the claim on two grounds:

(1) that the amount claimed was in excess of the amount due; and (2) that the claimant was not entitled to the priority asserted.

The drafts upon which the claim is based were purchased by the Post Office Department under the following circumstances, as appears at page :

> "Mr. Ryan.—For the record, perhaps we might inform his Honor exactly how the claim arises.
>
> "As you already know, the Post Office Department issues foreign money orders and, of course, the foreign countries issue orders on this country and at certain times there is an accounting and a balance struck. That is what happened in this case, a balance was struck.
>
> "Now the practice has been for the Postmaster-General to purchase drafts with which to pay the balances and in this case he went to Knauth, Nachod & Kuhne and purchased these drafts—the drafts are payable to the Postmaster-General and he endorses them to the different countries."

The Referee reduced the amount of the claim to the sum of $147,462.32, the amount urged by the Trustee, and the Government is not appealing from that portion of the Referee's order.

The Referee sustained the claim of priority and his order was successively affirmed by the District Court and by the Circuit Court of Appeals upon authority of the decision of Court in *Matter of Tidewater Coal Exchange,* 280 Fed., 848. No opinion was written in this case by the Circuit Court.

Errors Relied Upon.

The errors relied upon are:

(1) That the courts below erred in affirming the order of the Referee in allowing the claim of the United States through its Postmaster-General as a priority claim.

(2) The courts below erred in holding that the United States of America was entitled to priority in payment of its claim filed through its Postmaster-General over the claims of the general creditors of the bankrupt.

Brief of Argument.

The petitioner contends:

1. The right of the United States to priority is not an inherent sovereign prerogative, and priority must be created by Congress in the exercise of the powers delegated to it by the Constitution.

U. S. vs. *Fisher*, 2 Cranch, 358, 395;
U. S. vs. *Bank of North Carolina*, 6 Peters, 29, 35;
U. S. vs. *Canal Bank*, 3 Story, 79 (F. C. No. 14715);
U. S. vs. *Oklahoma*, 261 U. S., 253;
Equitable Trust Co. vs. *Connecticut Brass*, 290 Fed., 712;
Strain vs. *U. S. Fidelity & Guaranty Co.*, 292 Fed., 694; aff'd 264 U. S., 570.

2. The United States obtains its priority in bankruptcy, if any there be, from the Bankruptcy Act itself and not from Revised Statutes, Sec. 3466.

Guarantee Title & Trust Co. vs. *Title Guaranty and Surety Co.*, 224 U. S., 152;
U. S. vs. *Wood, as Trustee in bankruptcy*, 290 Fed., 109; affirmed 263 U. S., 680.

3. The Bankruptcy Act of 1898 contains no express grant of priority to the United States *eo nomine* for an ordinary indebtedness, and the history of that act and

of the earlier Bankruptcy Act shows that the world "person" as used in Section 64 of the Act includes only private creditors and was not intended to include the United States itself; and therefore that R. S. 3466 is not incorporated into the Act by reference.

Fleet Corporation vs. *Wood*, as Trustee, 258 U. S., 549, at 574 (concurring opinion of Chief Justice Taft and Justices Van-Devanter and Clarke);
Bankruptcy Act of 1800, 2 Stat., 19, 36;
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Guarantee Co. vs. *Title Guaranty Co.*, 224 U. S., 152;
H. R. 8110 (54th Congress, First Session);
House Report, 55th Congress, 2nd Session, No. 65;
Congressional Record, id. p. 1787.

4. The Bankruptcy Act of 1898 despite the definitions contained therein, is not free from ambiguity as to the status of debts due the United States and therefore the prior acts and the history of the Act of 1898 can be resorted to for the purpose of resolving the ambiguity.

5. The cases relied on by the Government in the Courts below are not controlling.

6. A failure of Congress to create a priority for ordinary debts due the United States is in accordance with an enlightened and desirable public policy, and the Courts should not be astute to spell out an intent to the contrary. When the Government descends to the role of the private citizen and enters into contract relations, the losses which it sustains in excess of its *pro rata* share

of the assets should not be borne *by the other creditors of the bankrupt* but by *all* the people.

U. S. vs. *Fisher,* 2 Cranch, 358, 402, dissenting opinion;
U. S. vs. *Oklahoma,* 261 U. S., 253;
Davis vs. *Pringle,* 1 Fed. (2d), 860, 864;
McPhee vs. *U. S.,* 62 Colo., 421.

POINT I.

The right of the United States to priority is not an inherent sovereign prerogative right, and priority must be created by statutes enacted by Congress in the exercise of its delegated powers.

That the foregoing is true with respect to ordinary debts due the United States has never been disputed.

U. S. vs. *Fisher,* 2 Cranch, 358, 395;
U. S. vs. *Bank of North Carolina,* 6 Peters, 29, 35;
U. S. vs. *Canal Bank,* 3 Story, 79 (F. C. No. 14715);
U. S. vs. *Oklahoma,* 261 U. S., 253;
Equitable Trust Co. vs. *Connecticut Brass,* 290 Fed., 712;
Strain vs. *U. S. Fidelity & Guarantee Co.,* 292 Fed., 694; Aff'd 264 U. S., 570.

In the *Fisher* case it was pointed out that Congress has the power to provide for the payment of the debts of the Union, and is authorized to *create* a priority in the Government's favor in the exercise of its power to make all laws necessary and proper for carrying out the foregoing express power.

POINT II.

The United States obtains its priority, if any, from the Bankruptcy Act of 1898, and is bound by its provisions.

Under the Act of 1867, it was held in *Lewis* vs. *United States*, 92 U. S., 618, that the priority of the United States arose under an Act of 1797, now Revised Statutes 3466, and that the priority created by the Bankruptcy Act was simply a precaution to reaffirm the priority of the Government in bankruptcy proceedings.

Under the Act of 1898, however, it has been held that the United States is bound by the provisions of the Bankruptcy Act, and that whatever priority it has for the payment of its ordinary debts, must be created by that Act. It was for that reason that the Circuit Court of Appeals held in *U. S.* vs. *Wood*, 290 Fed., 109, and that this Court concurred (263 U. S., 680), that the plenary suit in equity to charge the assets for a debt due the United States could not be maintained by virtue of R. S. 3466 under the Act of 1898 although it could be maintained under the 1867 Act.

In *Guarantee Co.* vs. *Title Guaranty Co.*, 224 U. S., 152, the question was whether a surety subrogated to the rights of the United States was entitled to a priority over a labor claim. It was decided in the court below, 174 Fed., 385, that the United States was not bound by the provisions of the Bankruptcy Act and that under the Act of 1797 (now Revised Statutes 3466) the Government was entitled to a prior payment irrespective of the provisions of the Bankruptcy Act. This Court reversed these conclusions and held that the present act evidenced a different intention. In order to determine whether the United States was mentioned in the Bankruptcy Act of 1898 and therefore bound by the provisions of Section 64 as to priorities, the Supreme Court points out three pro-

visions indicating that the United States was intended to be included within the Act:

Sec. 1, subdiv. 9, that a creditor shall include anyone who owns a demand provable in bankruptcy;

Sec. 17, that a discharge in bankruptcy releases the bankrupt from all of his provable debts except such as are due as a tax levied by the United States, and

Sec. 57-J, providing that debts owing to the United State as a penalty or forfeiture shall not be allowed except for the amount of the pecuniary loss sustained by the act, transaction or proceeding out of which the penalty arose.

After comparing the provisions of the Acts of 1867 and 1898 and indicating other changes, this Court says:

> "The Act [of 1898] takes into consideration, we think, the whole range of indebtedness of the bankrupt, national, state and individual, and assigns the order of payment."

The Court accordingly concludes that despite the provisions of Section 3466 of the Revised Statutes, granting a priority over all claims, the United States claim for an ordinary debt is, because of the provisions of Section 64, to be paid after a labor claim.

This decision left open the question what priority the United States did have upon allowance of a debt due it as distinguished from a tax and primarily the question left open was whether the United States itself, within the meaning of Subdivision 5 of Sec. 64, was a "person" who by the laws of the United States was entitled to priority and therefore entitled to priority over general creditors.

Therefore, there remains simply the question whether or not the Bankruptcy Act of 1898 does in fact create a priority in favor of the United States for ordinary debts. Concededly, it does not create such a priority in so many words. The narrow question is whether under the provisions of 64b (5) a debt due the United States is a debt

due a "person," so that it is entitled to priority, because such priority is created by a "law of the United States," to wit: R. S. 3466.

POINT III.

The Bankruptcy Act of 1898 contains no express grant of priority to the United States eo nomine for an ordinary indebtedness, and the history of that act and of the earlier Bankruptcy Acts shows that the word "person" as used in Section 64 of the present act includes only private creditors and was not intended to include the United States itself; and therefore that R. S. 3466 is not incorporated into the act by reference.

In Matter of Eastern Shore Shipbuilding Co., 274 Fed. 893, decided in the Circuit Court of Appeals for the Second Circuit Court in June, 1921, the question was whether a claim of the Fleet Corporation was entitled to priority in bankruptcy. The Trustee urged first: that the Fleet Corporation was not entitled to whatever priority the United States itself might have because it was merely a private corporation, and second: that if it was entitled to all the rights of the United States, the United States itself had no priority for an ordinary debt in bankruptcy. Both points were argued at length by the Trustee. That Court pointed out that the question as to the priority of the United States itself apparently never had been determined, and found that it was not necessary to determine it because the Court held that the Fleet Corporation was a private corporation and an independent contractor.

and therefore the debt was due to it and not to the United States.

On March 15, 1922, *Matter of Eastern Shore Shipbuilding Co.* (*supra*) was argued in this Court together with the *Sloan Shipyard* case and the *Astoria Marine Iron Works* case, the two latter cases involving the question of whether the Fleet Corporation could be sued other than in the Court of Claims, 258 U. S., 549. On the argument before this Court counsel for the Trustee* of the Eastern Shore Shipbuilding Co. argued at length that even if the Fleet Corporation were a governmental agency, the United States itself was not entitled to priority, and the argument was answered in the Government's brief. Most of the argument now presented was presented in that case. Six of the Judges were of opinion (258 U. S., 549) that the Fleet Corporation was not a governmental agency and therefore held in the *Sloan* case and in the *Astoria* case that suit would lie and in the *Eastern Shore* case that there was no priority. Chief Justice Taft and Justices Van Devanter and Clarke concluded that the Fleet Corporation *was* a governmental agency, and therefore they dissented from the conclusions in the *Sloan* and *Astoria* cases. They were able to concur, however, in the conclusion in the *Eastern Shore* case (258 U. S., at top 574) because they agreed with the Trustee's second contention that the statute as to preferences in bankruptcy does not extend to claims of the United States, except those for taxes.

Chief Justice Taft said (258 U. S. at top of p. 574):

> "As to the preference claimed against a bankrupt in No. 625 by the Fleet Corporation, I concur in the conclusion of the court that it can not be allowed under the statute as to preferences in bankruptcy, because I do not think it extends to claims of the United States except those for taxes."

*Counsel for the Trustee in that case was the same as in the case at bar.

It is important to note that the judgment of the three concurring justices was not a mere casual one, but was the determination of a question deliberately raised and argued. It is also important to note that that opinion is neither a dissenting opinion nor a dictum but an absolute holding in an opinion concurring with that of the majority of the Court so far as the *Eastern Shore* case was concerned. If the *Eastern Shore* case had been argued along it would have been termed a concurring opinion.

It is impossible to construe the Act of 1898 without a consideration of the earlier Bankruptcy Acts and the history of the bills which led up to the enactment of the present Act. They were examined by this Court in the *Title Guarantee* case, 224 U. S., 152, and in *Schall* vs. *Camors*, 251 U. S., at 250.

These are presumed to have been before Congress when it considered the present Act.

It is believed that this examination will show:

(*a*) That the Bankruptcy Acts of 1800, 1841 and 1867 in so many words reaffirmed and continued the priority created by the Statute of 1797, now 3466 R. S.

(*b*) That the Acts of 1841 and 1867, by separate provisions, in addition to such reffirmation of Government priority provided for the priority of "persons"; i. e., private creditors, who by the laws of the United States were given such priority.

(*c*) That the *bills* leading up to the final enactment of the Act of 1898 did not reaffirm or create a priority for *all* debts but expressly limited the Government's priority to debts to the extent that they constituted a lien, and separately *continued* the provision for the priority to persons who by the laws of the United States were entitled to priority which provision was in the earlier

acts and *added* a priority for persons entitled thereto under State laws.

(*d*) That the Committee Reports and Explanations to the House supports petitioner's contentions.

(*e*) That the Act of 1898 as finally enacted did not reaffirm or create a priority for *all* debts but substituted for the priority for debts which constituted a lien as contained in the preliminary bills a priority for and a direction to pay all *taxes* whether or not they constituted a lien leaving undisturbed the priority to "persons," i. e., private creditors, who were entitled to priority under the laws of the United States by the terms of the Act of 1867 and extended the latter priority in favor of persons entitled to priority under State laws.

The various earlier bankruptcy acts and the bills and reports heading up to the Act of 1898 will now be examined.

The Bankruptcy Act of 1800.

Prior to 1800 Congress had not exercised its delegated power to pass a bankruptcy act, but it had provide by Section 5 of the statute of March 3, 1797 (1 Stat. 512), as follows:

> "And be it further enacted, that where any revenue officer, or other person hereafter becoming indebted to the United States, by bond or otherwise, shall become insolvent, or where the estate of any deceased debtor, in the hands of executors or administrators, shall be insufficient to pay all the debts due from the deceased, the debt due to the United States shall be first satisfied; and the priority hereby established shall be deemed to extend, as well to cases in which a debtor not having sufficient property to pay all his debts, shall make a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed or absent debtor, shall be

attached by process of law, as to cases in which an act of legal bankruptcy shall be committed."

The act of bankruptcy therein referred to evidently referred to acts under State statutes.

The first Bankruptcy Act passed in 1800 provided (2 Stat., 19, 36):

> "And be it further enacted, That nothing contained in this law shall in any manner affect the right of preference to prior satisfaction of debts due to the United States as secured or provided by any law heretofore passed, nor shall be construed to lessen or impair any right to, or security for, money due to the United States or to any of them."

This provision was construed in *United States* vs. *Fisher*, 2 Cranch, 358, where the Court held that the purpose of the foregoing provision was simply to continue in a Federal bankruptcy proceeding the priority which had been granted to the United States by the Statute of 1797.

Thus the Act of 1800 did not itself *create* a priority for the United States, nor did it create any priority for private creditors who might be accorded preference under the laws of the United States or of the States.

The Bankruptcy Act of 1841.

This Act, 5 Stat., 440, 445, provides:

> "SEC. 5. And be it further enacted, That all creditors coming and proving their debts under such bankruptcy, in the manner hereinafter prescribed, the same being bona fide debts, shall be entitled to share in the bankrupt's property and effects, pro rata, without any priority or preference whatsoever, except only for debts due by such bankrupt to the United States, and for all debts due by him to **persons, who, by the laws of the United States, have a preference,** in consequence of having paid monies as his sureties, which shall be first paid out of the assets; and any

person who shall have performed any labor as an operative in the service of any bankrupt shall be entitled to receive the full amount of the wages due to him for such labor, not exceeding twenty-five dollars. Provided, That such labor shall have been performed within six months next before the bankruptcy of his employer." * * *

In this act is found for the first time the phrase which is the basis of the Government's claim and which has been repeated in all subsequent acts.

This Act, it will be noted, provided that the creditors proving their debts should be entitled to no prority except (1) debts due to the United States, (2) debts due to persons who by the laws of the United States were entitled to a preference in consequence of having paid money as sureties and (3) to wage earners for amounts not exceeding $25.00. In other words, there priority was expressly granted to the United States for its debts, and *in addition* priority was granted to persons who under the laws of the United States were subrogated to the rights of the United States under the Statute of 1797, now R. S. 3468, and also to a limited class of wage earners. *It is entirely clear, therefore, that under this Act of 1841, the word "persons" did not include the United States itself.* It is also to be noted that there was no priority granted to private creditors of the bankrupt other than sureties, even if granted priority under the laws of the United States or of the States. This provision of the Act does not seem to have been interpreted and the Act itself was repealed in 1843.

The Bankruptcy Act of 1867.

This Act (March 2, 1867), 14 Stat 530, C. 176, indicates clearly that Congress had in mind the distinction between ordinary debts due to the United States, moneys due as taxes and assessments, claims of wage earners, and also debts due to all persons, i. e., private creditors, who by

the laws of the United States were or might be entitled to priority. In Section 28 of that Act it was provided as follows:

> "In the order for a dividend, under this section, the following claims shall be entitled to priority or preference, and to be first paid in full in the following order:
>
> FIRST.—The fees, costs and expenses of suits, and the several proceedings in bankruptcy under this act, and for the custody of property, as herein provided.
>
> SECOND.—All *debts* due to the *United States, and* all *taxes* and assessments under the laws thereof.
>
> THIRD.—All debts due to the State in which the proceedings in bankruptcy are pending, and all taxes and assessments made under the laws of such state.
>
> FOURTH.—Wages due to any operative, clerk, or house servant, to an amount not exceeding fifty dollars, for labor performed within six months next preceding the first publication of the notice of proceedings in bankruptcy.
>
> FIFTH.—All debts due to any *persons*, who by the laws of the United States, are or may be entitled to a prority or preference, in like manner as if this act had not been passed; always provided, that nothing contained in this act shall interfere with the assessment and collection of taxes by the authority of the United States or of any State."

Here is a clear recognition of the distinction between debts and taxes due to the United States and debts due to "persons" who by the laws of the United States were or might be entitled to priority. *It needs no argument to show that in view of the fact that there was an express provision with respect to debts and with respect to taxes*

due to the United States in subdivision 2nd, that the words "debts due to any persons" in sub-division 5 was not intended to include debts due the United States itself.

The word "persons as used in sub-division 5 included sureties who were subrogated to priority under the Statute of 1797, now R. S., Section 3468. It also included any other persons who might be entitled to priority under the laws of the District of Columbia, or under the laws of any territory for there is no limitation as in the Act of 1841 to "Persons" who are entitled to priority in consequence of having paid monies as the bankrupt's sureties.

In *Lewis* vs. *United States*, 92 U. S., 618, this Court considered the relation between the above provision of the Act of 1867 and the Statute of 1797, and the Court said, with respect to the priority of the United States itself, after quoting Section 28 of the Act of 1867:

> "The clause above quoted is in *pari materia* with the several acts giving priority of payment to the United States, and was doubtless put in to recognize and reaffirm the rights which those statutes give, *and to exclude the possibility of a different conclusion.*"

It is clear, therefore, that under the Act of 1867 Congress, as it had done in each of the prior Acts, expressly reaffirmed the priority of debts due the United States over all indebtedness. In addition it extended and created priority in favor of certain "persons," that is to say, in favor of certain private creditors, whose claims were thus preferred after the debts of the United States and certain other indebtedness.

Certainly in the light of the holding in the Guarantee case, 224 U. S., 152, that there was a change of purpose, and that the act takes in consideration all of indebtedness of the bankrupt and in the light of the continued policy of Congress in the three earlier bankruptcy Acts speci-

fically to reaffirm or recreate in bankruptcy the priority of debts due the United States over the debts due private creditors and separately to provide for the priority of certain "persons," it cannot be presumed that when Congress copied into the Act of 1898 the provision granting a priority to debts due certain "persons" and deliberately omitted in the final enactment of the statute a priority for the debts due the United States, expressly limiting the priority to taxes, that it was intended by mere implication to extend the meaning of the word "persons" copied from the earlier acts to include not only private creditors but also the United States itself.

The Act of 1898.

The Act of 1898 worked a radical change not only in the specific preference accorded by the earlier Acts, but it made numerous references to the United States by name and made exact provision for its status and its rights arising from all classes of claims. It provided that a discharge should not discharge tax claim and indicated its purpose that the bankrupt was to be *discharged from provable debts* owing to the United States except for taxes. (See *United States* vs. *Wood*, 290 Fed., 109-115). It provided that debts owing to the United States as a penalty should only be allowed for the amount of the pecuniary loss. It specifically provided a priority for taxes but *omitted* the priority for debts which had been reaffirmed in the earlier Acts, although it did specifically provide, as above stated, for the discharge of such debts.

An analysis of the Act of 1898 shows the following: Section 17 provides:

> "(*a*) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as (1) are due as a *tax* levied by the United States, the State, county, district or municipality in which he resides."

Section 57J provides as follows:

> "*Debts* owing to the United States, a State, a County, a district or a municipality as a penalty or forfeiture shall not be *allowed*, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

In the foregoing provisions is found a distinct recognition of the existence of three classes of claims of the United States:

(A) Taxes;

(B) Debts owing as penalties;

(C) Debts generally.

Furthermore, debts owing to the United States are referred to in Section 57 and debts due any *person* entitled to preference by the laws of the United States are referred to in Section 64.

Having thus clearly indicated an intention that all classes of debts due the United States in bankruptcy are within the purview of and subject to the provisions of the Act, Congress in Section 64 provided for certain priorities.

In that Section again there is a clear distinction between taxes and debts. The order of priority is provided for as follows:

(*a*) All *taxes* due and owing to the *United States*, the State and political subdivision.

(*b*) Cost to preserve the estate.

(*c*) Filing fees and expenses of creditors who have recovered assets.

(*d*) Cost of administration.

(*e*) Wages.

> (*f*) Debts owing to any *person* why by the laws of the States or the United States is entitled to priority.

Reading the Act alone, it appears that Congress had in mind the various classes of debts due to the United States and deliberately determined just what indebtedness of the bankrupt should be entitled to prior payment and that it concluded that ordinary debts due the United States should not be given such a priority and should be allowed and discharged as private debts.

It is apparent, therefore, that the whole claim to priority is bottomed upon the proposition that despite these explicit provisions and references to the United States, and despite the deliberate omission of any specific provision for priority for ordinary debts, Congress by implication intended to create such priority by extending the meaning of the word "persons" to include the United States, although the same phrase in earlier acts clearly referred solely to private creditors, and that that extension of meaning was effectuated solely by means of the ambiguous definitions of terms used in the Act.

It now will be shown that the history of the Act of 1898 negatives any such intention and affirmatively shows that the intention was to the contrary.

History of the Act of 1898.

For some years prior to 1898, there was an agitation for the enactment of the Bankruptcy Law. A bill was drawn by Judge Torrey, which was introduced in the House in the early '90s and considered at successive sessions of Congress.

The Bill in 52nd Congress.

On June 27, 1892, the House Committee reported favorably on the Torrey Bankruptcy Bill (H. R. 9348, 52nd Congress, 1st Session). The Committee's report is House Report 1674 of that Congress and is found in Congressional Series No. 3048, House Reports No. 1674. That bill so reported by the Judiciary Committee provided as follows:—

> SECTION 64. (*a*) DEBTS WHICH HAVE PRIORITY.—Debts owing to the United States, a State, or municipality, after being proved and allowed shall have priority only in the event and to the extent that they constitute a lien upon the property of the estate.
>
> (*b*) The debts to have priority, except as herein provided, and to be paid in full out of bankrupt estates, and the order of the payment shall be (1) the filing fees paid by creditors in involuntary cases; (2) the cost of administration, including one reasonable attorney's fee, for professional services actually rendered irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary cases, as the court may allow; (3) wages due to workmen, clerks or servants which have been earned within three months before the date of the commencement of proceedings, not to exceed three hundred dollars to each claimant; and (4) debts owing to any person who by the laws of the States or the United States is entitled to priority."
>
> (*c*) [This is a provision for expenses incurred in good faith in cases where compositions are set aside.]

Clearly under this bill there was no intention to include an ordinary debt due the United States not a lien within the provisions of Subd. (b) (5), nor to include within the word "persons" the United States itself, for

there was an express provision in Subdivision A relating to debts owing to the United States, which provided that after being proved and allowed, such debts should have priority *only in the event and to the extent that they constitute a lien.* As the bill expressly mentioned "Debts owing to the United States" and limited their priority to a specific class of debts, it is not believable that Congress intended by implication to provide for another class of debts owing to the United States in Subdivision 5 and made such provision simply by extending the meaning of the word "persons" to include the United States, although that word in the prior acts clearly referred only to private creditors. *If that had been the intention a separate subdivision would have been inserted providing for priority for ordinary debts.*

The Bill in the 54th Congress.

Again in the 54th Congress, 1st Session, the House Judiciary Committee favorably reported a bill introduced by Speaker Henderson (H. R. 8110), which contained practically the same provisions as the bill above referred to. (See House Report 1228, 54 Congress, 1st Session, Congressional Record for that Session, p. 3931). In that bill thus favorably reported Section 64 read as follows:

Section 64: Debts which have priority.

> (*a*) Debts owing to the United States, a State, a county, a parish, or a municipality, after being proved and allowed, shall have priority only in the event and to the extent that they constitute a lien upon the property of the estate.
>
> (*b*) The debts to have priority except as herein provided, and to be paid in full out of bankrupt estates and the order of payment shall be:
>
> (1) the actual and necessary cost of preserving the estate subsequent to filing the petition; (2) the filing fees paid by creditors in involuntary cases; (3) the cost of administration, including the fees and mileage payable to witnesses as now or

hereafter provided by the laws of the United States, and one reasonable attorney's fee for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases, to the bankrupt in involuntary cases while preparing the duties herein prescribed, and to the bankrupt in voluntary cases, as the court may allow; (4) wages due to workmen, clerks, or servants which have been earned within three months before the date of the commencement of proceedings, not to exceed three hundred dollars to each claimant; and (5) debts owing to any person who by the laws of the States or the United States is entitled to priority.

This bill differed from Judge Torrey's bill only in that the priority was extended to debts owing to a county and a parish in addition to those owing to the United States, a state or a municipality. Here again, however, it is entirely clear that debts owing to the United States were provided for in Subdivision "a" and priority allowed only in the event and to the extent that they constituted a lien upon the property of the estate.

55th Congress.

In April, 1897, a similar bill was reported by the Senate Judiciary Committee. The bill, as reported, contained the following (Cong. Record, 55 Congress, 1st Session, pp. 601-609):

SECTION 65: Debts which have priority

(*a*) *Debts* owing to the United States, a State, County, Parish, being a political corporation, District, or Municipality, after being allowed, shall have priority *only in the event and to the extent that they constitute a lien upon the property of the estate.*

(*b*) (1, 2, 3 and 4 are like the present Section 64). "5. Debts owing to any *person* which by the

laws of the United States or a State ar entitled to priority."

This bill differed from the House bill in that it inserted after the word parish, "being a political corporation."

Senator Nelson's Substitute Bill, 55th Congress.

The bill was not enacted as reported but Senator Nelson on April 22, 1897, offered a substitute bill which passed the Senate on that day. That bill provided as follows (Cong. Rec., 55 Congress, 1st, Session, p. 800):

"SEC. 9. That the following debts shall have preference in the order named over other debts in the distribution of the estate of the bankrupt, to wit:

FIRST.—Debts due to servants and laborers employed by the bankrupt for labor performed or services rendered within six months prior to the filing of said petiton.

SECOND.—Taxes or revenues due the United States.

THIRD.—Taxes due any State or Territory or the District of Columbia.

FOURTH.—Taxes due any county, parish, etc.

But none of such debts shall be recognized or paid unless duly proved and allowed as prescribed in reference to other debts and claims against the bankrupt."

This bill, it will be noted, extends the priority from debts, which are a lien, to all taxes, *but does not purport to create any priority for ordinary debts due the United States or for debts due persons.*

Final House Bill, 55th Congress.

That bill was referred to the House Committee. That Committee recommended that the enacting clause of the Senate Bill be stricken out and in lieu thereof it recommended another bill which was in essence similar to H. R. 8110 introduced in the First Session of the 54th Congress, which bill is referred to above, except that changes were recommended in the priority clause. The bill as proposed by the Committee contained the same provisions as were eventually contained in the bill which became a law. The House Judiciary Committee Report, report No. 65, 55th Congress, 2nd Session, was presented December 16, 1897.

Committees Report as to Changes.

In discussing the changes in H. R. 8110 of the 54th Congress which were recommended, the Committee said at page 27 of its report with respect to the proposed changes in Section 64:

> "Under the head of debts which have priority, a provision is recommended requiring trustees to recognize first taxes due to the United States, State, County, District or Municipality, to be paid before any dividend is paid to creditors. This to apply whether the taxes are a lien or not upon property."

That is to say, the Committee recommended that instead of the provision that there should be priority for debts owing to the United States only in the event and to the extent that they constitute a lien upon the property of the estate, there should be a direction to the trustee to pay taxes, whether or not they were a lien. This was an extension of the Government priority as contained in the earlier bill, for under Section 3186 of the Revised Statutes

then in force, taxes only become a lien after notice of the assessment was filed in the Collector's office and a demand was made.

From the foregoing, it is apparent that the intention was to prefer only indebtedness due the United States which arose by virtue of the exercise of the taxing power and not indebtedness which arose out of contractual relations. Nowhere is there any indication of any intention to create a priority for ordinary contractual debts or any intention to reaffirm the priority which might exist under the Statute of 1797, now R. S. 3466, as was done in all the prior acts.

Mr. Henderson's Explanation to the House.

This is further confirmed by the explanation of the bill made by Mr. Henderson, Chairman of the Judiciary Committee on the floor of the House. He said (Cong. Record, 55th Congress, 2nd Session, p. 1787, at top):

> "Debts which shall have priority are the actual costs of preserving the estate, the filing fees paid by creditors, the cost of administration, wages due workmen, clerks, or servants which have been earned within three months, not to exceed $300 each, and debts owing any person who by the laws of the States or the United States is entitled to priority."

The Chairman did not read the definitions contained in the bill to the House; he did not say that the term "any person" included sovereign corporation or the States or the United States or had other than its ordinary meaning. Clearly he did not have or intend to convey the thought to the House that under this provision debts due the United States were preferred. His explanation is of controlling importance and is most persuasive evidence that the word "person" was used in the Act of 1898 in its ordinary sense as it was in the

earlier acts, namely, to designate private creditors of the bankrupt.

The bill thus explained passed the House and went to the Senate. Thereafter a conference committee agreed upon a bill which contained the same provision as in the House bill (Senate Document 294, 55th Cong., 2nd Session) and this bill became a law.

Summary of Historical Review.

From the foregoing discussion the following appears:

(*a*) The Act of 1800 specifically preserved the priority created by the Statute of 1797 and created no priority for persons, i. e., private creditors.

(*b*) The Act of 1841 again preserved or created a priority for debts due the United States *and in addition* created a priority for two classes of "persons", i. e., for private creditors who had priority under the laws of the United States as sureties for debtors of the United States, and for wage earners.

(*c*) The Act of 1867 "reaffirmed" in bankruptcy the priority granted by the Statute of 1797, and in addition *extended* the priority in bankruptcy to *all* persons, i. e., private creditors as were or might be entitled to priority under the laws of the United States thus including not only sureties but priority claimants under the laws of the District of Columbia and of the territories and any persons to whom priority might be granted thereafter by any Federal statute.

(*d*) The bills in Congress leading up to the Act of 1898 eliminated the priority for all debts due the United

States and preferred "Debts owing to the United States," only in the event and to the extent that they constituted a lien and by separate provision continued and extended the priority in bankruptcy to persons, i. e., private creditors so as to include creditors entitled to priority not only under the laws of the United States *but also under the laws of the States.*

(*e*) The Act of 1898 as passed limited the priority to taxes whether or not they constituted a lien. This Act also discharges debts due the United States other than taxes and provides that debts for penalties are to be allowed only for the actual damage sustained, thus indicating that sovereign rights existing under the Act of 1867 were eliminated.

Conclusions from Historical Review.

In *Guarantee Co.* vs. *Title Guaranty Co.*, 224 U. S., 152, this court said:

> "And we cannot say that it was inadvertent. The act takes into consideration, we think, the whole range of indebtedness of the bankrupt, national, state and individual, and assigns the order of payment."

As these changes were not inadvertent and the Act takes into consideration the whole range of indebtedness of the bankrupt, national, state and individual, and assigns the order of payment, and as ordinary debts are discharged the intent of Congress is clear to curtail the rights of the Government and upon ordinary debts to place the Government upon the plane of an ordinary citizen. *If the intention had been to give it priority for ordinary debts as distinguished from taxes, it is not conceivable that the draftsmen of the Torrey bill and*

the subsequent bills which led to the enactment of the Act of 1898 would have deliberately removed from the Act of 1867 the express priority for debts due the United States contained in Section 28 of the Act of 1867, and first would have limited such priority to "debts" which are a lien and finally to taxes. If the intention was to continue the priority and make it subordinate to wage claims, the language of the Act of 1867 would not have been eliminated and so important a right would not have been allowed to rest upon ambiguous definitions and implications. On the contrary, a separate sub-division with respect to ordinary debts due the United States would have been inserted.

The draftsmen of the Act of 1898 were, of course, familiar with the decision in the *Lewis* case, 92 U. S., 618, which held that the express priority for debts was inserted in the Act of 1867 to recognize and reaffirm the rights created by the Statute of 1797 *"and to exclude the possibility of a different conclusion."* Knowing, therefore, that there was this possibility of a "different conclusion," what possible reason could there be for Congress deliberately to fail to recognize or create the priority for the United States *in so many words* as was done in the 1867 Act? Why should the express priority of the Act of 1867 have been eliminated unless Congress intended to eliminate the right itself?

It now will be shown that the definitions contained in the act and the application of the provisions of Section 64 do not forbid the adoption of the foregoing conclusion as suggested by the Referee and by the opinions in the *Tidewater* case.

POINT IV.

A.

The Act of 1898 despite the definitions therein contained is not free from ambiguity as to the status of debts due the United States and therefore the prior acts and the history of the Act of 1898 can be resorted to for the purpose of resolving the ambiguity.

B.

The reasoning in the Tidewater case is not controlling.

"A."

The Referee held that the Act of 1898 in the light of the definitions therein contained was so free from ambiguity that resort could not be had to the prior acts and to the history of the Act of 1898 to determine the question presented.

Section 1a of the Bankruptcy Act provides as follows:

> "The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows * * *
>
> (6) 'Corporations' shall mean all bodies having any of the powers and privileges of private corporations not possessed by individuals or partnerships, and shall include limited or other partnership associations organized under the laws making the capital subscribed alone responsible for the debts of the association.
>
> (19) 'Persons' shall include corporations, except where otherwise specified, and officers, part-

> nerships, and women, and when used with reference to the commission of acts which are herein forbidden shall include persons who are participants in the forbidden acts, and the agents, officers and members of the board of directors or trustees, or other similar controlling bodies of corporations."

Definitions contained in an act are themselves subject to construction by the courts, like all other parts of an act. They should not be extended beyond their necessary import nor should they be allowed to defeat the intention of the legislature. If these definitions specifically provided that the term "person" should include the United States or a State there would be no room for construction. Because they do not so provide, because they are to say the least ambiguous and because the clear intention of Congress in enacting Section 64 in its present form has been shown to be to eliminate priority for debts due the United States, the definitions by strained construction cannot be permitted to thwart the legislative intent.

As said by Mr. Justice BUTLER in *Barrett* vs. *Van Pelt* decided April 13, 1925.

> "Being satisfied of the legislative intention, the Court will not be prevented from giving that intention effect by a too rigid adherence to the very word and letter of the Statute, *Oates* vs. *National Bank*, 100 U. S. 239, 244."

As pointed out by BLACKBURN, J., in *Lindsay* vs. *Cundy*, 1 Q. B.D. 348, 358 in construing definitions and their application the courts cannot close their eyes to the fact that the use of definitions in statutes is a comparatively modern innovation and frequently leads to confusion because definitions give a non-natural sense to words which are afterwards used in a natural sense without regard to the distinction. That principle is peculiarly applicable here for an attempt is being made to extend the

obvious natural meaning of "persons" as used in Section 64 and in prior acts to include the Sovereign.

Assuming that the United States is a corporation sovereign, it is submitted that the definition of corporations above set forth was not intended to include the United States, but by its very language was limited to private corporations, joint stock companies, limited partnerships or other partnership associations organized under the laws of the various states in all of which there was a right of succession and in some a limited liability of the members, as contrasted with powers and privileges and liabilities of individuals and partnerships. Congress, of course, realized that the laws of the various states differed in their terminology with respect to organizations which were not strictly private corporations and not the ordinary partnership and therefore used the language quoted to cover those classes of organizations of which the essential features were continuity and limited liability. In some states there is no limited liability of members of such organizations and in others the liability is limited to the capital subscribed. *In view of the fact that throughout the Act the States and the United States are referred to in haec verba it is not believable that Congress would have failed specifically to include the United States and the States in so many words it had intended that they or either of them should be included within the definitions just as certain partnership associations were thus included in the definition.* It is not believable that Congress would have left the rights of the United States or the States to be asserted by mere implication. Certainly it is a peculiar "judicial process" which leads to the conclusion that these definitions *without any doubt* include the United States and therefore eliminates the possibility of examining the history of the legislation and the Act as a whole as an aid in construing what must certainly be considered at least an ambiguity as to the scope of

the defintion and as to whether the definition is inconsistent with the context.

As above indicated in numerous places throughout the Act, Congress has referred to the United States by name and specifically in Section 64 has created a priority for the United States and the States for taxes. Consequently the failure of Congress *in so many words* to create a priority for ordinary debts in the very section which specifically creates such a priority for taxes is most persuasive evidence of Congressional intention that the priority for debts should no longer exist. And yet the Referee finds not the slightest ambiguity or doubt and by a most technical application of definitions and without regard to the context of the very section, he has determined that no reference can be made to the prior Act and their interpretation by the Courts and to the history of the particular Act under construction.

An examination of the Act as a whole shows the use of the word "person" time and again under circumstances, where it is entirely clear that no sovereign corporation was intended to be included and where the intention was to include only natural persons, strictly private corporations and those bodies which possessed some of the attributes of a partnership and some of a private corporation. For example:

Section 2, subdivision 16 provides that the court of bankruptcy has power to punish "persons" for contempt.

Section 3 (a) provides what acts of bankruptcy by a "person" shall consist of.

Section 3 (b) provides that a petition may be filed against a "person" who is insolvent and who has committed an act of bankruptcy.

Section 3 (d) provides that whenever a "person"

against whom a petition is filed denies the allegations of insolvency, he shall appear on the hearing, etc.

Section 3 (e) provides that whenever a petition is filed by any person and a temporary receiver is applied for a bond shall be given.

Section 4 of the original Act of 1898 (30 Stat. 544) provided that any person, except a corporation, could become a voluntary bankrupt, and Section 4 (b) in the original Act provided that any natural person, except certain specified individuals and certain corporations engaged in certain lines of business, might be adjudged an involuntary bankrupt, and of course here there would be included not only a strictly private corporation, but also in pursuance of the definition bodies engaged in those lines of business having the attributes of a private corporation (such as joint stock associations and partnership asociations).

The present act as amended by the Acts of 1903 and 1910 extends the right to file a voluntary petition to any person *except* certain classes of corporations and extends the class of corporations against which petitions may be filed. As the United States and a State are not specifically excluded, under the reasoning of the Referee a State or the United States being corporations not within the excepted class could file voluntary petitions.

Section 16 (a) provides that the liability of a "person" who is a co-debtor with or guarantor for the bankrupt shall not be discharged.

Section 20 (b) provides any person conscientiously opposed to the taking of an oath may in lieu thereof affirm.

Section 29 in all its subdivisions provides that a "person" may be punished for offenses under the Act.

In the light of the foregoing, can it be argued that the court is bound to hold that there is no possible room for construction; that "persons" in 64 without doubt includes the United States and that it must shut its eyes to the history of the past and present acts in ascertaining the true intent of Congress in continuing the priority for "persons" which originated in the Act of 1841.

Of course, the primary question is what was the intention of Congress in Section 64 of the Act and this intention, it is submitted, cannot be ascertained by the process of reasoning to which the Referee has limited himself. Cases can be found construing some Statutes which hold that the word "persons" or the word "corporations" include the sovereign and on the other hand cases to the contrary are also in the books. Precedents on this question are not helpful inasmuch as the legislative intent with respect to each individual statute is controlling *and in the absence of a specific provision that the term "corporation" as used in this Act shall include the United States,* it is submitted that to arrive at the true Congressional intent the Court must examine the prior Acts and the history of this Act as an aid to arriving at the true construction. This was done by the Court in construing the Bankruptcy Act in the *Title Guaranty* case, 224, U. S., 152 and in *Schall* vs. *Camors,* 251 U. S., at 250.

As stated in *Davis* vs. *Pringle,* 1 F. (2d) 860, 863:

> "The failure to include the United State and the states in the definition could not have been inadvertent. The United States and the several states of the Union are not persons, and are not commonly thought of as persons, and if it had been intended that 'persons' should have such a comprehensive and unsual meaning as to include them, the framers of the definition would have said so.
>
> Again, when the Congress had already dealt with claims of the United States under the name of the

> United States, and had deliberately limited its priority to taxes, it is hardly reasonable to attribute to the Congress an intention to deal again with the claims of the United States and include them in a provision relating to debts of 'any person.' "

It is submitted that the Referee's view is a narrow and erroneous one and that it does *not* appear clearly from the definitions alone that the United States as a sovereign corporation is included in the terms "person," and that it does appear, inconsistent with the context of Section 64, to hold that the United States is included in the word "person." *In the absence of definitions which specifically include the United States or a state within the meaning of the word "person," the court must be free to examine the history of the legislation in order to ascertain the true legislative intent.* Such examination it has already been shown leads to the indubitable conclusion that no priority for ordinary debts due the United States was intended to be created by the Bankruptcy Act of 1898.

B.

The reasoning in the Tidewater case is not controlling.

In the *Matter of Tidewater Coal Exchange*, 280 Fed., 648 certiorari denied in *Davis* vs. *Coyle*, 260 U. S., 721, upon which case the decree below in the present case was based, the question presented to the District Court and to the Circuit Court of Appeals was whether the United States as a contract creditor was entitled to vote in the election of a trustee in bankruptcy. *Both parties conceded the priority,* but the United States claimed that the provision of the Bankruptcy Act which precluded private creditors with the priority from voting, did not apply to the United States. The District Court and the

Circuit Court of Appeals as a preliminary to the consideration of the question of the right to vote discussed the sources of the priority without having before it the argument now presented, and both courts held, in accordance with counsel's concession that the priority did exist and they found as its basis the provisions of Section 64 (b) (5) of the Bankruptcy Act.

In his opinion in the Circuit Court of Appeals, Judge Rogers stated, 280 Fed. at 650 that "if" under the Bankruptcy Act priority is given, it must be because of Section 64 (5) (b), and then added that the Court had no doubt that the United States was to be regarded as a person within the meaning of that clause. No reasons are advanced for the conclusion. The statement of the court that the statutory provision is "simply *declaratory* of the common law rule which entitled a sovereign to priority over all creditors of an insolvent" is inaccurate and can find no basis in the decision of *United States* vs. *National Surety Co.*, 254 U. S., 73, 75, which is cited in support of the statement. This court in that case said that Section 3644 *embodied* the common law rule, which is of course a wholly different thing and is quite in accord with the cases cited in Point I hereof to the effect that the Federal Government did not inherit the priority of the crown of England and that the right of the United States to priority is solely a statutory right created by Congress in the exercise of its delegated powers.

Of course, the question here presented was not discussed in the National Surety case (see discussion of this case in Point V) for there both parties evidently conceded that the United States had a priority in payment and the only question which the Court considered was whether a surety which paid part of a claim due the United States was as to that payment entitled to equal priority with the United States, which asserted a claim for the balance due.

In his opinion in the *Tidewater* case in the District

Court,* after quoting the language of Section 64 (b) (5) Judge LEARNED HAND said:

> "This language fits precisely because the United States is a corporation sovereign and corporation are 'persons' under Section 1 (*a*) (19)."

This syllogism, it is submitted, overlooks the fact however, that the act itself limits the word "corporations" in Section 1 (*a*) (6) to those there specified and there is certainly no precise indication in that definition that sovereign corporations were intended to be included as has already been shown at length.

Judge HAND further said in the *Tidewater* case:

> "Moreover so far as anyone has found it [the United States] is not only a 'person' but the only 'person' * * * entitled to priority under any law of the United States."

This statement, even if correct, leads to this conclusion: That although Congress must have known that no person other than the United States itself was entitled to priority under the laws of he United States, nevertheless instead of doing the obvious and natural thing namely, continuing a priority for the United States *eo nomine*, Congress created that priority in the United States by eliminating the express priority found in the earlier acts and by leaving the priority to be spelled out of so tortuous a phrase as "person who by the laws of the United States is entitled to priority," which phrase in the prior acts and bills as already shown clearly referred to private creditors.

It cannot be seriously argued that a priority was created by any such method.

It is submitted, however, that the statement that the United States itself is the only person entitled to pri

*The opinion is not reported but is found in the record in *Davis v. Coyle*, 260 U. S., 721 (October Term, 1922, No. 399).

ority under the laws of the United States, is, in fact, incorrect. By virtue of the provisions of Section 64 A of the Act, taxes are to be paid first, and included within the term taxes are not only income taxes and the like, but also duties imposed under the tariff acts.

Matter of Rosenthal, 235 Fed., 315.

Accordingly, it is clear that a trustee in bankruptcy under the provisions of Section 64 A is required first to pay any duties which may be owing by the bankrupt. If bonds have been given to secure the payment of duties and the sureties upon such bonds have discharged the obligation, then by the laws of the United States, to wit, R. S. 3468,* such sureties would be entitled to priority, but under the provisions of Section 64 (*b*) (5) would be entitled to priority only in advance of general creditors and after administration expenses and wage claims. In other words Section 64 (*b*) (5), modifies the general right of subrogation contained in R. S. 3468 so that the *surety* is not paid ahead of wage claimants although the tax which the surety paid would be paid ahead of such claimants if the tax were still due the United States.

Because of the definition of "States" contained in Section 1 (*a*) (24)* where that word is defined to include the territories and the District of Columbia the technical argument may be advanced that the priorities granted

*R. S. 3468 provides:

Priority of Sureties. Whenever the principal in any bond given to the United States is insolvent, or whenever, such principal being deceased, his estate and effects which come to the hands of his executor, administrator, or assignee, are insufficient for the payment of his debts, and, in either of such cases, any surety on the bond, or the executor, administrator, or assignee of such surety pays to the United States the money due upon such bond, such surety, his executor, administrator, or assignee, shall have the like priority for the recovery and receipt of the moneys out of the estate and effects of such insolvent or deceased principal as is secured to the United States; and may bring and maintain a suit upon the bond, in law or equity, in his own name, for the recovery of all moneys paid thereon.

*Section 1 (24) of the Bankruptcy Act provides:

"'States' shall include the Territories, the Indian Territory, Alaska, and the District of Columbia."

to persons by the laws of District of Columbia and of the territories are not granted by the "United States," but by the "States" so that the only persons who are entitled to priority under the laws of the "United States are sureties. It may well be doubted whether Congress in inserting the word "States" in 64 (*b*) (5) had in mind the definitions of States in Section 1 (*a*) (24) but even if it did it still remains true that sureties on bonds for import duties and other taxes would be entitled to priority. It is not true, therefore, it is respectfully submitted that there are no "persons" other than the *United States* now entitled to priority under the laws of the United States.

Whether Congress made this critical analysis is exceedingly doubtful* and the most reasonable assumption is that the *underlying purpose of the provisions was to preserve and continue whatever priorities existed to private creditors under the laws of the United States and to extend the right of priority to persons entitled thereto under the laws of the State.* It must be repeated that it is not conceivable that Congress deliberately omitted the express priority granted in the Act of 1867 and intended that the right to such priority should be spelled out of a series of ambiguous definitions and other provisions intended to grant priority to certain private creditors. No rules of statutory construction require such a conclusion and it will be shown in Point VI post that such construction is not required by a sound public policy as to the status of ordinary debts due the United States.

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*In Section 3 (*a*) 4 of the act there is a reference to the laws of "a State, of a Territory or of the United States," thus indicating how the definition of "States" contained in the act was overlooked.

POINT V.

The cases relied on by the Government in the courts below are not controlling upon the question here presented.

In *United States* vs. *National Surety Co.*, 254 U. S., 73, the interpretation of the Bankruptcy Act was in no wise considered. There a surety company paid part of a claim due to the United States and claimed the right under Section 3468 of the Revised Statutes to equal priority for the amount so paid with the United States, which was asserting priority for the balance due it from the bankrupt. Both sides assumed that the United States had a priority under Section 3466 and the only question was as to the relative rights of the Government and the surety. The *briefs* and the opinion in that case indicate that the question now presented for decision was neither raised nor decided. No reference was made to the provisions of Section 64 of the Bankruptcy Act, to the earlier bankruptcy acts, nor to the decision in the *Guarantee* case. Furthermore, in *United States* vs. *Wood* as trustee, 263 U. S. 680, the *National Surety* case was unsuccessfully urged as an authority to sustain the contention that the Government's priority arose under Section 3466 and that, therefore, a plenary suit in equity could be maintained to charge the assets in the hands of the trustee, just as it was sustained under the 1867 Act in *Lewis* vs. *United States*, 92 U. S. 618. This contention, however, was overruled, this court holding that the rights of the United States arose solely under the Bankruptcy Act itself. In the *National Surety* case, this court simply determined the relative rights of the Government and the surety under the Revised Statutes, *without being asked to and without in fact considering the effect of the Bankrupcty Act*

upon those provisions or upon the status of Government claims. That case, therefore, cannot be deemed as authority on the question here presented. As stated by Mr. Justice SUTHERLAND in the very recent case of *Webster* vs. *Fall*, 60 L.Ed., 174, 175:

> "The most that can be said is that the point was in the cases if any one had seen fit to raise it. Questions which lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents."

2. In *Matter of Western Implement Co.*, 166 Fed., 576, affirmed on opinion below, 171 Fed., 81 (8th Circuit), it was held that a state was entitled to priority for an ordinary debt in bankruptcy.

It is important to note that Judge Van Devanter, who, as a Circuit Judge, concurred in the decision of the Circuit Court of Appeals, subsequently concurred in the opinion in this Court in the *Guarantee* case, and was one of the Justices of this Court in the *Eastern Shore* case, who concluded that the United States has no priority in bankruptcy. It is also important to note that the District Court in its opinion relied in part upon the decision in the *Stoever* case, 127 Fed., 394, the doctrine of which was subsequently overruled.

Irrespective of these considerations, it is apparent that the Court in the *Western Implement* case without regard to context or history, concluded that a person included a corporation and that a corporation included a sovereign, and referred to general definitions of corporations, which are not determinative of the meaning of words used in the Bankruptcy Act. Furthermore, the argument there advanced that most but not all of the states hold that a sovereign state has taken over the prerogative of the King of England to the prior payment of taxes and ordinary debts is not persuasive of the fact that Congress in 1898 in the light of the conditions then

existing did not determine that there no longer should be any priority in bankruptcy for ordinary debts whether due to a state or to the United States. In the earlier Acts, debts due a sovereign were not discharged in bankruptcy, and yet Congress in 1898 eliminated these rights of the Federal and State governments.

In view of these provisions, it is not difficult to conceive as the Court suggests that Congress intended to render nugatory the policy of priority to the extent of ordinary debts, and that this was accomplished by a mere failure to insert some express provision covering the subject. What more need Congress have done than to provide an express priority for taxes, omit the express priority for ordinary debts which was in the prior acts, preserve the rights of "persons" in the earlier acts and provide that the debts due the United States, the State or municipality should be discharged as ordinary debts. As stated by Judge Hand in his opinion in the *Tidewater* case, referred to above, the Act contains indications "that except in the matter of taxes, it was intended to put the United States in the same position as other creditors." The whole argument of the court in the *Western Implement* case is contrary to the later conclusions of this Court in the *Title Guarantee* case that Congress *did* intend to change the general priority of the United States and the States which existed under the Bankruptcy Act of 1867 and Revised Statutes 3466.

(3) *Matter of Hibner Oil Co.*, 264 Fed., 667. This case has been cited by various courts as holding that a debt due the United States was entitled to priority in bankruptcy. An examination of the case and of the briefs indicates, however, that priority was conceded and the only question was whether the Director-General was entitled to the Government's priority. At page 10 of the appellant's brief in that case, a copy of which has been examined by counsel, appears the following statement:

> "The appellant herein admits that contractual debts due to the United States of America are fifth in order of payment in a bankruptcy case, or have priority over general unsecured creditors, but the trustee contends, etc."

It was because of this statement that the court, in its opinion, said:

> "If the claim is property of and constitutes a debt due to the United States then concededly its priority was properly found."

(4) *In Re Stoever*, 127 Fed., 394 the Court reached the conclusion that the United States was entitled to priority over all creditors, including wage earners, and the reasoning of that case was followed by the Circuit Court of Appeals of the Third Circuit in the *Guarantee Company* case in 174 Fed., 385. Of course, the latter decision was overruled by this Court.

(5) *Lewis* vs. *United States*, 92 U. S., 618, was decided under the Act of 1867 and its doctrine has been held inapplicable to the Act of 1898, both in the *Guarantee* case and in *United States* vs. *Wood*.

(6) *In re Anderson*, 279 Fed., 525, involved the question whether the United States could be compelled to file its claim for taxes. It is entirely true that in this case there is a dictum that debts due the United States come after wages due workmen. But the statement was not necessary to the decision or was there apparently any consideration of the argument now presented.

(7) *United States* vs. *Oklahoma*, 261 U. S., 253, has no bearing whatever on the question here. In that case the only question was whether a debtor had been divested of his property in one of the methods specified in R. S. 3466, and the court held that as the debtor had not been so divested, the United States had no priority, because

the priority was the creation of statute and the case did not come within its terms. *The decision does show how strictly this court has construed the right to priority for over a century.*

POINT VI.

A failure of Congress to create a priority for ordinary debts due the United States is in accordance with an enlightened and desirable public policy and the Courts should not be astute to spell out an intent to the contrary. When the government descends to the role of the private citizen and enters into contract relations, the losses which it sustains in excess of its pro rata share of the assets should not be borne by the other creditors of the bankrupt but by all the people.

The reasons moving Congress no longer to give a preference to ordinary debts due the United States and to provide for their discharge in bankruptcy are entirely understandable.

The right of priority of the United States is wholly statutory and priority was given for the purpose of sustaining the public burdens.

In *United States* vs. *Bank of North Carolina*, 6 Peters, 29, 35, the Court said:

> "The right of priority of payment of debts due to the government, is a prerogative of the crown well known to the common law. It is founded not so much upon any personal advantage to the sovereign, as upon motives of public policy, *in or-*

der to secure an adequate revenue to sustain the public burdens, and discharge the public debts.

The first preference was given by the Statute of 1797. In those days, the Republic needed all moneys which it could obtain from any source to pay its debts and it was apparently deemed wise to secure prior payment of Government moneys no matter from what source they were due or for what reason, even at the expense of the private general creditors of the bankrupt; and so, throughout the earlier years of the country's history and at the close of the Civil War with its strain on government revenues, it was apparently deemed essential that the preference contained in the Statute of 1797 should be continued by the Act of 1867 and that the private creditor must sacrifice his rights of equality for the public good.

In 1898, a different condition prevailed. The nation was rich and prosperous. The need for sustaining the "public burdens" was not so pressing. Government activities and dealings with the ordinary citizens were increasing. The injustice of allowing priority to contract debts due the Government was patent. The absence of a national bankruptcy law had led to grave abuses and one of its underlying purposes was to provide for the equality of division of assets between creditors. Of necessity, the taxes must be preferred, for the Government must have its revenue for operation, but no apparent reason appeared at that time why the Governmen should be preferred in the payment of claims (to use the language of Justice McKenna in the *Guarantee* case, "growing out of personal conventions as distinguished from civil obligations." The Act expressly provides that all debts due the United States, except taxes, are discharged and that debts for penalties should not be allowed, except as indicated. Thus some of the old rights based on the notion of priority of the sovereign

are expressly eliminated. The obvious intention was that ordinary debts due the United States should be proved, allowed and in every respect should be subject to the provisions of the Act.

No reason can be advanced why this is not an enlightened and desirable public policy.

As early as 1805, Mr. Justice Washington in his dissenting opinion in *U. S.* vs. *Fisher,* 2 Cranch., 358, 402, rebelled against the construction of the Statute of 1797 which preferred the United States over private creditors on ordinary debts. He said:

> "The nature of the debt may well warrant a discrimination; but not so, if the privilege be merely of a personal nature. The sovereign may, in the exercise of his powers, secure to himself this exclusive privilege of being preferred to the citizens, but this is no evidence that the claim is sanctioned by the principles of immutable justice. If this right is asserted, individuals must submit; but I do not find it in my conscience to go further in advancement of the claim, than the words of the law, fairly interpreted, in relation to the whole law, compel me. But I do not think that Congress meant to exercise their power to the extent contended for. First, because in every other section of the law they have declared a different intent; and secondly, because it would not only be productive of the most cruel injustice to individuals, but would tend to destroy, more than any other act I can imagine, all confidence between man and man. The preference claimed is not only unequal in respect to private citizens, but is of a nature against which the most prudent man cannot guard himself. As to public officers, and receivers of public money of all descriptions, they are, or may be known as such; and any person dealing with them, does it at the peril of being postponed to any debt his debtor may owe to the United States, should he become unfortunate. He acts with his eyes open, and has it in his power to calculate the risk he is willing to run. *But if*

this preference exists in every possible case of contracts between the United States and an individual, there is no means by which any man can be apprised of his danger in dealing with the same person.''

The Statute there under consideration expressly created a priority for *all* debts and therefore it forbade the construction for which Judge WASHINGTON contended.

How much truer were his words in 1898. Then the government was a contractor and a buyer in the chief centers of the country. The business relations of the Government with its citizens have increased enormously since that time through its various agencies, departments and enterprises, and the smallest merchants find themselves in contractual relation with the government. In view of this situation, did not Congress deliberately omit the preference of the Government's ordinary debts, because it was believed that when the Government contracted with the ordinary citizen, it should have no greater or other rights than other contractors or creditors of the persons with whom it might deal? If the contrary be the law, then in these days of Government activities, no one can safely give credit to any mercantile concern which has Government contracts. For if bankruptcy ensues the entire assets may be payable to the Government as damages and the private merchants will receive nothing.

That this happens in numerous cases where there are *tax* claims is known to all. In the past few years there have been many cases in which tax claims first asserted after bankruptcy have consumed all assets remaining for distribution. The hardship ensuing to ordinary private creditors should not be extended at this time when the Government is asserting enormous contract claims growing out of its wartime operations. Judge Hand in his opinion in the District Court in the *Tidewater* case

has recognized the soundness of this view in his discussion of the rule as to whether statutes apply to the United States, for he says:

> "It is especially inapplicable when governments enter into commerce, as here, or industry, and assume duties and obligations and acquire rights and interests under exactly the same rules as private persons. Surely it is intolerable in such cases that the community at large having undertaken collectively the role of a private association should assert privileges, immunities and exemptions to which no one similarly situated is entitled and which, so far as they have any justification whatever, depend upon ideas long since obsolete and derived from a totally different conception of the relations of the individual to the ruler."

By the recent decisions in the *Oklahoma* case, 261 U. S., 253, and *Equitable Trust* vs *Connecticut Brass Co.*, 290 Fed., 712, the priority of the United States for ordinary debts in distribution in equity receivership and the like has been denied and Congress has not amended the statute—R. S. 3466.

In *Davis* vs. *Pringle*, 1 Fed. (2d) 860 at 864, the Circuit Court of Appeals said:

> "No sound principle of public policy can be invoked in support of preference to the federal government and to the states over citizens in the collection of ordinary debts. On the contrary, the contractual operations of the federal government and of the states have become so extensive and so involved with the business of private citizens that priority to the federal government and to the states, except for taxes, would operate as an oppressive hardship on other creditors of bankrupts."

In *Davis* vs. *Michigan Trust Co.*, 2 F. (2d) 194, 197, the Court said:

> "Judicial opinion as well as legislation is examining anew the proper privileges and immunities to be accorded the sovereign State, and in cases not clearly covered by Statute or decision, the correct solution is not to be found by the application of an abstract formula, but by the most careful consideration of the public needs and the practical requirements of law in the modern industrial community."

In *McPhee* vs. *U. S.*, 62 Colo., 421, cited with approval by this Court in *U. S.* vs. *Wood*, 290 Fed., 109 the Court in holding that debts other than taxes due the United States were discharged in bankruptcy said:

> "The United States, when it engaged in business enterprises should be subject to the same laws and occupy no different position than individuals when so engaged."

The argument of the Government that the claim of the Postmaster General arises out of the performance of purely governmental function and therefore as a matter of public policy the claim should be preferred just as a tax claim, of course, does not bear analysis. Every claim must be one or the other. *Either the United States has a priority for all claims growing out of a contract or it has priority for none.* The courts cannot prefer one contract claim and disallow preference to another.

Upon what possible theory of public policy should the United States, as the purchaser of a draft from international bankers, as in the present case be preferred over the ordinary citizen who has made a similar purchase? Upon what possible theory of public policy under present conditions should the United States be paid in full and the loss be borne by the private creditors? Profits from Government operations belong to all the people; losses should be borne by all. In any case in which the United States is a contract creditor, the debt has been incurred in the performance of some governmental func-

tion, in pursuance of the direction of Congress, and whether it be the purchase of a draft or the operation of a ship or the purchase of supplies, the essential fact is that the *United States has descended to the role of an ordinary citizen and divested itself of its sovereign character* and should not have its obligation paid at the expense of others who have dealt with the same common debtor.*

The bankruptcy act is founded on equitable principles and one of the elementary principles is that equality is equity. There is no apparent reason why that principle should not now apply to the status of debts due the United States and debts due private creditors of a bankrupt debtor.

It is submitted that this Court should now hold that by the very language of the Act of 1898, in the light of its history, and from considerations of sound public policy Congress has determined that the early rule should no longer obtain, that the Act of 1898 is all inclusive, and that debts due to the Government growin out of private conventions should be treated on a par with the debts due the ordinary citizen and that the losses which the government may sustain in excess of its *pro rata* share of the assets should not be borne *by the other creditors of the bankrupt,* but should be paid from the general revenues contributed by all the people.

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*Compare *United States Bank* vs. *Planters Bank*, 9 Wheat., 904, 906, where the Court says:

> "It is, we think, a sound principle, that when a government becomes a partner in any trading company it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to its associates, and to the business which is to be transacted."

POINT VII.

The order should be reversed and the Court below directed to enter an order decreeing that the claim of the United States is not entitled to priority over the claims of general creditors of the bankrupts.

Respectfully submitted,

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